San Francisco City and County Employees' Retirement System

SFERS
San Francisco Employees' Retirement System

July 29, 2020

VIA ELECTRONIC FILING

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655 U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Re: RIN 1210-AB95, Financial Factors in Selecting Plan Investments proposed rule

Dear Director Canary:

On behalf of the San Francisco Employees' Retirement System ("Retirement System" or "SFERS"), thank you for the opportunity to submit comments on the notice of proposed rulemaking entitled "Financial Factors in Selecting Plan Investments," Regulatory Identifier Number (RIN) number 1210-AB95 ("Proposal" or "NPR").

About SFERS

SFERS was established by approval of City voters on November 2, 1920 and the California State Legislature on January 12, 1921. SFERS has approximately $27 billion in assets and serves nearly 71,000 active and retired employees of the City and County of San Francisco and their survivors.

SFERS is solely dedicated to securing, protecting and prudently investing pension trust assets, administering benefits programs, and providing promised benefits to the active and retired members of the City and County of San Francisco.

As stated in SFERS' Environmental, Social, and Governance (ESG) Procedures, "*SFERS believes that certain environmental, social, and governance (ESG) factors can have a material impact on the value of companies and securities, as well as affect the macroeconomic environment more broadly. Consideration of material environmental, social, and governance (ESG) factors alongside traditional financial factors should therefore provide a better understanding of the risk and return characteristics of investments.*

SFERS is committed to incorporating ESG factors into its management of the Plan in a manner that is consistent with the Retirement Board and Staff's fiduciary responsibilities to act in the best interests of the members, retirees, and beneficiaries of the Retirement System and consistent with SFERS' role as a prudent, long-term investor."

Comments on the Proposed Rule

We found the Proposal to be lengthy and confusing. We believe the Proposal should provide clarity to fiduciaries as to when ESG factors may be included in investment decision-making and provide clarity as to what is not permissible.

For example, the Department refers to terms such as "ESG vehicles", "ESG-themed", and "ESG Investment Alternatives." SFERS does not consider ESG factors to be a standalone asset class. Rather, we view ESG factors to be relevant to the financial risks and returns of an investment, just as factors such as valuation, positioning for revenue and cash flow growth, managements vision, strategy, and ability to execute, corporate culture, ability to recruit and retain top talent, personnel turnover, company, industry and sector fundamentals, balance sheet quality, macroeconomics, political, regulatory, and other considerations are also relevant.

As another example, we believe that the evaluation of ESG factors is relevant to prudently investing SFERS' assets and that it enhances our ability to manage investment risk and return. There is now an extensive body of research that demonstrates that ESG factors do impact investment risk and return. Our own experience is that many leading investment managers incorporate material ESG considerations into their investment strategies as part of their process to generate superior risk-adjusted returns. This is the basis for our decision to integrate ESG factors into our investment decision-making.

A policy by the Department, alone, that clarifies that fiduciaries should integrate material factors into their investment actions and that ESG factors may be material would be appropriate. We are concerned the Proposal could create uncertainty and cause fiduciaries to believe they are not permitted to consider material ESG factors in their investment analysis.

Regarding the Proposal, we believe it would be helpful for the Department to distinguish between ESG integration and impact investing (or economically targeted investing). ESG integration is the inclusion of material ESG factors (i.e., those ESG that may influence risk and return) in investment analysis and investment decision making. Impact investing, on the other hand, seeks to generate positive environmental and/or social impacts and may (but does not necessarily) subordinate investment risk and return to achieve those impacts.

We believe the distinction between ESG integration and impact investing is important. ESG integration is consistent with prudence and a fiduciary's duty to act only in the economic best interest of plan beneficiaries. Impact investing may be more willing to subordinate investment risk and return in exchange for achieving an environmental, social, or governance impact.

Recommendation

The Proposal states that an ERISA fiduciary has fulfilled its obligations if they have "selected investments and/or investment courses of action based solely on pecuniary factors." It goes on to state that, "ESG factors and other similar factors may be economic considerations."

We recommend that the Department state that:

1. Fiduciaries may determine that environmental, social, and governance factors impact risk and return using an evidence-based approach, and in such cases these factors should be incorporated into investment decision making.

2. Investment decisions that subordinate investment risk and return to environmental, social, or governance concerns or those made for philanthropic purposes are not permitted.

Conclusion

SFERS' duty is to act solely in the best long-term interests of our beneficiaries. Using an evidence-based approach, it is our assessment that ESG factors have a material on an investments risk and return. If the Proposal goes into effect, we believe it may adversely impact the economic best interest of our beneficiaries. As such, we recommend the Department adopt the recommendations and comments included herein or allow the existing guidance to remain in effect.

Sincerely,

Jay Huish
Executive Director

William J. Coaker Jr.
Chief Investment Officer